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WORKERS' COMPENSATION ISSUES

A Report to the 52nd Legislature

from the

Joint Select Committee

on Workers' Compensation

Prepared by Paul E. Verdon, Staff Researcher

Montana Legislative Council
Room 138, State Capitol
Helena, MT 59620

December 1990

MEMBERSHIP:

THE JOINT SELECT COMMITTEE ON
WORKERS' COMPENSATION

Sen. Gary C. Aklestad,
Chairman

Sen. Paul S. Svrcek

Sen. Gene Thayer

Sen. Bob Williams

Rep. Jerry Driscoll,
Vice Chairman

Rep. Mary Ellen Connelly

Rep. William E. Glaser

Rep. Lum Owens

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CHAPTER NO. 12

[HB 62]

JUNE 1989 SPECIAL SESSION

AN ACT ESTABLISHING A JOINT SELECT COMMITTEE ON WORKERS' COMPENSATION; DEFINING THE POWERS AND DUTIES OF THE COMMITTEE; APPROPRIATING FUNDS FOR USE BY THE COMMITTEE; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND A TERMINATION DATE.

WHEREAS, last year, the actuary of the state workers' compensation plan No. 3 determined that, as of June 30, 1988, an unfunded liability of $157.3 million existed in the state fund of the Montana workers' compensation insurance system; and

WHEREAS, the actuary now projects that the unfunded liability in the state fund will increase to $215.2 million by June 30, 1989; and

WHEREAS, this increase in the unfunded liability in the state fund has occurred despite legislation enacted in 1987 to reform the Montana workers' compensation insurance system; and

WHEREAS, current plans to reduce the unfunded liability would require substantial increases in workers' compensation insurance premiums, which many businesses cannot afford because their rates are already too high; and

WHEREAS, other options need to be explored for reducing or eliminating the unfunded liability in the state fund; and

WHEREAS, the state fund should be neither more nor less than self-supporting and completely solvent; and

WHEREAS, there is a need to ensure that employers have a cost-effective system for insuring their workers' compensation liability; and

WHEREAS, current problems of the state fund are detrimental to the business climate of the state.

THEREFORE, the Legislature of the State of Montana finds it appropriate to establish a joint select committee on workers' compensation.

Be it enacted by the Legislature of the State of Montana:

Section 1. **Definitions.** As used in [this act], unless the context requires

otherwise, the following definitions apply:

(1) "Committee" means the joint select committee on workers' compensation established in [section 2].

(2) "State fund" means the state compensation insurance fund referred to in 39-71-2301.

Section 2. **Joint select committee on workers' compensation.** (1) There is a joint select committee on workers' compensation.

(2) The committee consists of eight members who must be appointed as follows:

(a) two members of the house of representatives appointed by the speaker of the house;

(b) two members of the house of representatives appointed by the house minority leader;

(c) two members of the senate appointed by the president of the senate; and

(d) two members of the senate appointed by the senate minority leader.

Section 3. **Term of office -- vacancies.** (1) A member of the committee shall serve until January 1, 1991.

(2) A vacancy on the committee must be filled in the same manner as the original appointment.

Section 4. **Officers -- meetings -- quorum -- compensation.** (1) The committee shall choose from its membership a chairman and vice chairman.

(2) The committee shall meet upon the call of the chairman or at the request of a majority of its members.

(3) Five members constitute a quorum for the transaction of business.

(4) Members of the committee are entitled to compensation and expenses as provided in 5-2-302.

Section 5. **Staff assistance -- committee support.** (1) The legislative council shall provide staff assistance to the committee.

(2) The office of the legislative auditor; the department of labor and industry; and the board of directors, the executive director, and management staff of the state fund shall assist and cooperate with the committee as may

be required for the committee to carry out its duties.

Section 6. **Duties of committee.** The committee shall undertake and complete a thorough study of the workers' compensation insurance program under plans No. 1 and 2 and plan No. 3, the state fund. In conducting this study, the committee shall:

(1) hold public hearings and gather information from private citizens, state government officials, and other interested persons concerning the problems affecting the state fund;

(2) review the laws and policies governing workers' compensation;

(3) examine the current costs, benefits, and operation of the state fund, including the establishment of rates and classifications for coverage under the state fund;

(4) study all matters affecting the costs of and premium rates charged for workers' compensation insurance;

(5) determine reasons for the increasing unfunded liability in the state fund;

(6) analyze the projected costs of operating the state fund;

(7) evaluate the future projected unfunded liability in the state fund;

(8) determine the specific revenue requirements to operate the state fund and to eliminate the unfunded liability;

(9) identify options to reduce costs, lower rates, and ensure the future solvency of the state fund;

(10) study the feasibility and advisability of selling or abolishing the state fund; and

(11) report its findings and present options for legislative consideration to the 52nd legislature by no later than October 1, 1990, and, if appropriate, prepare legislation to implement any of these options.

Section 7. **Powers of committee.** In performing the duties described in [section 6], the committee may:

(1) investigate and examine any issue it determines to be pertinent to the conduct of its business;

(2) request assistance and information from any state agency;

(3) subpoena witnesses, books, records, and other documents;

(4) administer oaths to witnesses in any matter under examination by the committee;

(5) request preparation of bills and resolutions as may be required for presentation at any meeting of the committee; and

(6) hire an independent consultant to audit the information and procedures used to determine the financial liabilities and revenue requirements for operation of the state fund.

Section 8. **Appropriation.** There is appropriated from the workers' compensation tax account, established in 39-71-2504, to the legislative council for the biennium ending June 30, 1991, the sum of $40,000 to be used by the committee on workers' compensation to conduct the study required by [this act].

Section 9. **Effective date.** [This act] is effective on passage and approval.

Section 10. **Termination.** [This act] terminates July 1, 1991.

Approved July 11, 1989.

WORKERS' COMPENSATION ISSUES
REPORT AND RECOMMENDATIONS

The Joint Select Committee on Workers' Compensation:

- carefully considered the system established and regulated by the State of Montana to provide, without regard to fault, wage supplement and medical benefits to a worker suffering from a work-related injury or disease;

- solicited and received advice and counsel from:

  -- those agencies within Montana state government charged with administering and implementing the workers' compensation laws;
  -- the consulting actuary retained to advise on the premium rates necessary to maintain the fiscal integrity of the system;
  -- the organization retained to classify occupations according to hazards in each category of work in order to recommend adjustments in rates necessary to reserve prudently against the inherent or demonstrated risks in those occupations;
  -- participants in the system, including insurers, employers, and beneficiaries; and
  -- concerned citizens;

- reviewed the means employed for financing the costs of the workers' compensation system and for controlling those costs;

- considered management precepts to restrain and contain an unfunded liability whose growth in the previous 4 years threatened to bankrupt the system and nullify the state's assurance of financial security to those unfortunate victims of injuries suffered in their workplaces or illnesses contracted on

their jobs; and

- contracted with an actuarial consultant to perform an independent evaluation of the actuarial projections and reserving processes of the State Compensation Mutual Insurance Fund.

Therefore, the Joint Select Committee on Workers' Compensation respectfully submits this report to the 52nd Legislature and recommends the enactment of:

-- LC 6 [see Appendix A], a bill to amend section 39-71-2106, MCA, to broaden the discretion of the Department of Labor and Industry to allow it to accept as a security deposit from an employer who elects to be bound under Compensation Plan No. 1 [a self-insurer] a certificate of deposit as well as a surety bond, government bond, or letter of credit; and

-- a bill to clarify that, except to the extent and for the purposes specifically exempted or excluded, the workers' compensation system is subject to all statutes prescribing state agencies' authority, expressly including the requirement that rates promulgated by the State Compensation Mutual Insurance Fund under Plan No. 3 are subject to review by the Administrative Code Committee. **[This recommendation was superseded by the enactment of Chapter 4, Special Laws of May 1990 [HB 2]. The provisions of this recommendation were included in sections 9 and 11 of HB 2.]**

The Committee further agreed not to consider and declined to recommend the sale of Plan No. 3, the State Fund.

COMMITTEE ACTIVITIES

The Joint Select Committee on Workers' Compensation gathered three times in Helena to consider the subjects embraced in its statutory charge:

October 4, 1989

After electing its officers and receiving a tentative study plan, the Select Committee:

- heard reports from the Administrator of the Workers' Compensation Division and the Commissioner of the Department of Labor and Industry on the progress toward reorganization of Plan No. 3 (State Fund) into the State Compensation Mutual Insurance Fund required under Chapter 613, Laws of 1989 [SB 428], and on the possible creation of an assigned risk plan, an option allowed under SB 428;

- received suggested topics of inquiry from insurers, risk management specialists, and other participants in the area of workers' compensation;

- took no action on retaining a professional consultant to advise the Select Committee;

- to assure that all subjects of concern are addressed, agreed that each member of the Select Committee should pose up to three questions to form a questionnaire to be submitted to the State Fund, the State Fund's actuary, the National Council of Compensation Insurance, the Legislative Auditor, and other knowledgeable persons; and

- agreed not to consider the sale of the State Fund as an

alternative after exploring this avenue and finding no interest on the part of potential purchasers because of the huge unfunded liability.

December 7, 1989

In addition to receiving and considering responses to the questions posed by each member after the previous meeting, the Select Committee received statements from:

- Drew James, vice president and senior consulting actuary, C&B Consulting Group, who outlined the facts, assumptions, and calculations that are used to reach actuarial conclusions with particular reference to those that led to the recommendation for rate increases of 20% for the State Fund in each of the next 2 years and who explained that the unfunded liability soared because of inadequate reserving prior to 1985, when the deficit first became apparent;

- Stacy Hennessy, workers' compensation insurance specialist with the American Insurance Association, who related Montana's situation to conditions prevailing nationwide and pointed out that every state insurance fund is in trouble, some in even more severe straits than Montana's;

- George Wood, executive secretary of the Montana Self-Insurers' Association, who put the responsibility for the workers' compensation systems' problems on unexpected court decisions in the early 1980s that awarded greater benefits to claimants. Mr. Wood stated that the 1987 reforms appear to be working and recommended that the three-plan system be continued, that no assigned risk plan be established, and that concerns be

refocused from the size of the State Fund's unfunded deficit to maintenance of its cash flow.

- James T. Harrison, Jr., chairman of the board of the State Compensation Mutual Insurance Fund, and Pat Sweeney, Administrator, Division of Workers' Compensation, who outlined plans to be implemented January 1, 1990, for the State Fund under the provisions of SB 428;

- Mike Micone, Commissioner of the Department of Labor and Industry, who reported on progress of reorganization of the Department required on January 1, 1990, by SB 428; and

- Norm Grosfield, representing Montana Workers' Compensation Council, an association that includes self-insurers, private insurance carriers, claims lawyers, defense lawyers, and rehabilitation experts and that was a principal mover in drafting legislation that resulted in the enactment of SB 428. The Council believes the effects of major changes made in 1987 in the benefits area and in 1989 in the structure area may take as long as 3 years to be felt. Apart from some technical changes, the Council believes that the law as amended in 1987 and 1989 should not be disturbed until its effectiveness is tested.

March 2, 1990

The Select Committee received statements from:

- John Lawyer, President of Lawyer Nurseries, Plains, on the effectiveness of Chapter 641, Laws of 1989 [SB 315], which provided employers the option of a medical deductible clause in workers' compensation insurance policies. He suggested that neither the National Council on Compensation Insurance nor the

Division of Workers' Compensation supports the concept, which dooms it to failure regardless of its merits.

- John E. Lacy, Jr., Director of Government, Consumer, and Industry Affairs, National Council on Compensation Insurance, explaining that NCCI is licensed in 32 states to assist and advise in the administration of the workers' compensation classification system. The purpose of classification is to enhance the basic principle of loss sharing by rating employers with others in their own industry to derive statistics reflective of that single industry.

- James T. Harrison, Jr., chairman of the board of the State Compensation Mutual Insurance Fund, who stated that the board was considering, as an option to a 20 percent increase in rates in each of the next 2 years, a proposal to issue bonds to be redeemed over 30 years in order to raise funds while reducing the premium increases necessary in each of the next 2 years to 10 to 12 percent;

- Frank Fairman, managing director of the public finance department, Piper, Jaffray & Hopwood, who outlined the details of the bonding proposal;

- Bill Johnstone, attorney with the firm of Dorsey and Whitney, who advised the State Fund that he believes it has authority to borrow money;

- John MacMaster, attorney for the Administrative Code Committee, who conveyed the request from the ACC that the Select Committee recommend legislation requiring the State Fund to comply with the provisions of the Montana Administrative Procedure Act. (By vote of 5-2, with one member absent, the Committee approved the request.)

- staff on provisions of a suggested draft bill to allow the Department of Labor and Industry to accept certificates of deposit as security deposits from Plan No. 1 self-insurers. (The Committee approved the bill for introduction by vote of 7-0, with one member absent.)

Lacking agreement on the necessity for another meeting and anticipating that the May 1990 Special Session would strengthen the workers' compensation system as found necessary since the end of the June 1989 Special Session, the Select Committee adjourned to the call of the chairman.

EVALUATING ACTUARIAL RESERVES AND INCURRED CLAIMS

After 4 months of inactivity that overlapped the May 1990 Special Session, the Select Committee was polled by mail at the request of Vice Chairman Driscoll to determine if the members favored retaining an actuarial consultant to conduct an independent review of the reasonableness of the actuarial reserves and incurred claims of the State Compensation Mutual Insurance Fund, using industry standards as generally applied by other state workers' compensation insurance entities.

A favorable majority response resulted in the Select Committee conducting two telephone conference meetings.

September 19, 1990

The Select Committee by unanimous vote:

- affirmed its earlier decision to retain an actuarial consultant to perform an independent review of the State Fund; and

- instructed the staff researcher, with the advice and assistance of the staff of the Legislative Auditor, to prepare a Request for Proposal for evaluation of the actuarial reserves and incurred claims of the State Fund, to be submitted to two firms that had earlier replied affirmatively to an inquiry about their interest in performing such a function.

October 2, 1990

After receiving proposals from the two firms, the Select Committee decided by unanimous vote to accept the proposal of and to contract with Joseph T. Flynn & Associates, Ltd., of Alameda, California. That firm's offer of $25,500 was

the lower of the two proposals and was within the Select Committee's budget. The Select Committee conditioned its approval on a submission of a report by the middle of November.

Mr. Joseph T. Flynn agreed to complete his work and submit a first draft report in writing no later than November 16, 1990, and to present the final report in person to the Select Committee on November 26, 1990. The summary of the findings of the independent review is included in Appendix B.

SPECIAL SESSION ACTS ON WORKERS' COMPENSATION ISSUES

The May 1990 Special Session passed and the Governor approved HB 2, which:

- separated the liability of the workers' compensation insurance program and fund on the basis of whether the liability arises from claims for injuries resulting from accidents that occurred before July 1, 1990, or accidents that occur on or after that date;

- authorized loans from reserves of the State Fund from premiums attributable to wages payable on or after July 1, 1990, for payment of claims for injuries resulting from accidents that occurred before July 1, 1990;

- established separate funding and accounts for claims represented by the unfunded liability and claims represented by new business;

- increased legislative oversight of the State Fund;

- clarified the State Fund's duties;

- prohibited the State Fund from issuing bonds;

- ensured compliance with the mandate that the State Fund set premiums for new business at a level sufficient to ensure solvency;

- made permanent and reduced from 0.3 percent to 0.28 percent the workers' compensation payroll tax; and

- provided a special method of offering negotiated settlements for claims arising prior to July 1, 1990.

MEMBER'S SUPPLEMENTAL COMMENTS

After reviewing the original draft of this report, Senator Paul Svrcek requested that his additional comments be included:

Given the power vested in this committee by the enabling legislation, I submit that its work has been lackluster. True, several of us were involved in the process of formulating the revisions enacted by the Special Session. While we have attended to the most severe wound, there are still many smaller ones that will continue to weaken the patient if they are not addressed.

Other than taking testimony from concerned parties, little more than lip service was paid to the very real problems:

- *Fraud, both by service providers and by dishonest workers;*
- *Lack of cooperation in establishing a deductible program within the workers' compensation system;*
- *Allegations of inadequacy and mismanagement in the vocational rehabilitation segment of the system;*
- *Lack of continuity, understanding, and consensus in the ratemaking recommendation and adoption process; and*
- *Imbalance of adequate access to, representation to, and service provided to workers, employers, service providers, and insurers.*

These serious problems faced Montana's workers' compensation system when the committee was formed. They could have and should have been more effectually addressed by the committee,

and they remain serious problems by virtue of the committee's lack of deliberation on them.

The charge of the Joint Select Committee on Workers' Compensation is fulfilled with the publication of this report.

APPENDIX A

*** BILL NO. ***** LC0006

INTRODUCED BY **********

BY REQUEST OF THE JOINT SELECT COMMITTEE ON WORKERS' COMPENSATION

A BILL FOR AN ACT ENTITLED: "AN ACT TO ALLOW A SELF-INSURED EMPLOYER UNDER WORKERS' COMPENSATION PLAN NO. 1 THE OPTION OF PROVIDING A CERTIFICATE OF DEPOSIT AS SECURITY; AMENDING SECTION 39-71-2106, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 39-71-2106, MCA, is amended to read:

"39-71-2106. Requiring security of employer. (1) The department may require any employer who elects to be bound by compensation plan No. 1 to provide a security deposit. ~~Such~~ The security deposit may be a surety bond, government bond, certificate of deposit, or letter of credit approved by the department and must be the greater of:

(a) $250,000; or

(b) an average of the workers' compensation liabilities incurred by the employer in Montana for the past 3 calendar years.

(2) ~~If the department finds that an employer has lost his solvency or financial ability to pay the compensation herein provided to be paid which might reasonably be expected to be chargeable to the employer during the fiscal year to be covered by the permission or that the employer is an association, corporation, or organization of individual employers seeking permission to operate under compensation plan No. 1, the department must require the employer, before granting to him permission or before continuing or engaging in such employment subject to the provisions of compensation plan No. 1, to give security in addition to the security described in subsection (1) for the payment of compensation, which security must be in such an amount as the department finds is reasonable and necessary to meet all liabilities of the employer which may reasonably and ordinarily be expected to accrue during the fiscal year.~~ (a) The department shall require an employer to give security in addition to the security described in subsection (1) if:

(i) the department determines that the employer

is insolvent or lacks the financial ability to pay the compensation that is required under this chapter and that is chargeable to the employer during the fiscal year to be covered by the permission provided for in 39-71-2103; or

(ii) the employer is an association, corporation, or organization of individual employers seeking permission to operate under compensation plan No. 1.

(b) The additional security required in subsection (2)(a) must be an amount that the department finds reasonable and necessary to meet all liabilities that the employer may accrue under this chapter during the fiscal year.

(3) (a) The security provided for in subsection (2) must be deposited with the department and may be ~~a certain~~ either an estimated percent of the employer's last preceding annual payroll or a ~~certain~~ percent of the established amount of his annual payroll for the fiscal year~~; or the~~. The security may ~~be in the form~~ consist of:

(i) a bond or undertaking executed to the department in the amount to be fixed by it with two or more sufficient sureties, which undertaking must be conditioned that the employer will ~~well and truly~~ pay or cause to be paid to his employees all sums

and amounts for which the employer ~~shall become~~ becomes liable under the terms of this chapter ~~to his employees~~ during the fiscal year; or ~~such security may consist of~~

(ii) any state, county, municipal, or school district bonds or the bonds or evidence of indebtedness of any individuals or corporations ~~which~~ that the department ~~deems~~ considers solvent~~;~~ ~~and every such~~.

(b) Every deposit and the character and amount of ~~such~~ the securities ~~shall~~ must at all times be subject to approval, revision, or change by the department as ~~in its judgment~~ it may ~~be required, and upon~~ require.

(c) Upon proof of the final payment of the liability for which ~~such~~ the securities are given, ~~such~~ the securities or any ~~remaining part thereof shall~~ remainder of the securities must be returned to the depositor.

(4) The department is liable for the value and safekeeping of all ~~such~~ deposits or securities and shall, at any time, upon demand of a bondsman or the depositor, account for the ~~same~~ deposits or securities and the earnings ~~thereof~~ of the deposits or securities."

NEW SECTION. Section 2. **Saving clause.** [This

act] does not affect rights and duties that matured, penalties that were incurred, or proceedings that were begun before [the effective date of this act].

NEW SECTION. Section 3. **Effective date.** [This act] is effective on passage and approval.

-End-

APPENDIX B

FINDINGS

A review of claim files found consistent management standards reflective of the recent court decisions. Case loads per claim examiner are high and therefore preclude good claim management. Case loads now appear to be reducing and hopefully will lower claim costs.

Reserves on large claims were reviewed and found to be reasonable. A new computer reserving system has just been implemented for use by claim examiners to set reserves. Until now, reserves for all claims were established by a reserve specialist. This change should result in faster setting of reserves and lower cost to reserve a claim, but also sacrifices some consistency. Large claims will still be reviewed by the reserve specialist.

A significant increase in medical subrogation recoveries has occurred in the last year.

Based upon claim payments through June 30, 1990, reserves for the fiscal years 1986 through 1989 have been understated. The understatements appear to be the result of (a) deteriorating claims experience not necessarily detectable on a statistical basis at the time reserves were established and (b) the overoptimism of the expected investment income generated by the reserves. Since these reserves are used to determine incurred claims, an understatement of reserves results in an understatement of incurred claims. In establishing premium increases, the incurred claims for the most recent full fiscal year are used. To the extent that incurred claims are understated for a fiscal year, the next premium increase will be understated.

Of serious concern is the ability of the payroll tax to payoff the liability at year end 1990 in a reasonable time period. Our calculation of the amount of this liability is reasonably close to the State Fund estimate using their 7% discount. However we question using a discount rate since few assets are available to earn income on this amount. Consideration might be given to requiring the State Fund to write business at a higher percentage of NCCI rates and the extra premium could be used to help pay for the year end 1990 liability on old claims.

We believe it is important to have a functional cost study performed on the State Fund operations to determine a reasonable level of expenses to be charged for processing claims and that an annual audit be made of claim processing to

assure timely and effective processing. In addition reopened claims should be reviewed to be assured that they are classified properly.

Reconstructing the financial statements it appears that $100 million of the $220 million deficit occurred for fiscal years 1985 through 1987 and that the balance of the loss was for claims incurred prior to that time.

SB315 appears to have reduced compensation claims by about 30% and medical costs have leveled for the last three fiscal years. Some concern exists over the increase in benefit costs when the freeze in the medical fee schedule and average weekly wage expires.

The premium rate increase of 8.6% could be somewhat low as we calculate the amount to be about 12.2%.

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